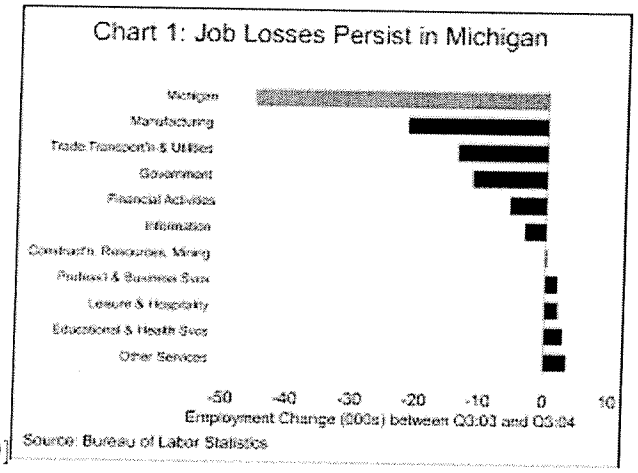
FEDERAL DEPOSIT INSURANCE CORPORATION
INSURING AMERICA'S FUTURE

FDIC State Profiles

Michigan State Profile - Winter 2004

Michigan's economic recovery remains lackluster.

- Michigan continues to lose jobs, although the recent pace was less severe than during 2001 through 2003. Employment fell 1 percent in the year ending third quarter, ranking Michigan among the weakest nationwide. The manufacturing sector, which accounts for about 16 percent of Michigan jobs, trimmed payrolls more than other sectors in the past year (See Chart 1).



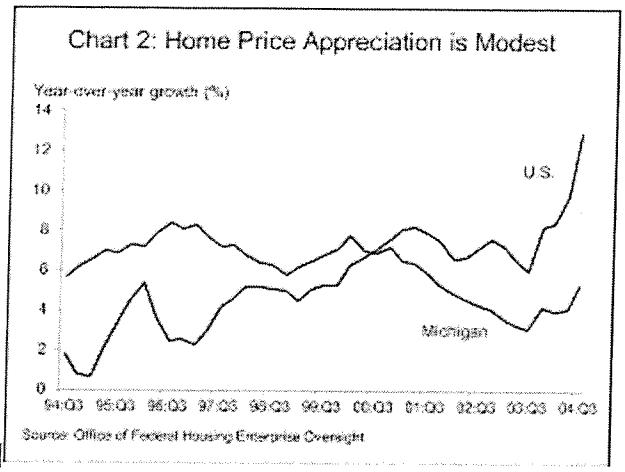
[D]

- The motor vehicle and parts industry, which accounts for about one third of Michigan's manufacturing jobs, is a source of recent weakness. These firms cut payrolls by 18,400, accounting for 84 percent of manufacturing jobs lost during the past year. Increased costs of metal and petroleum-based products are dampening profitability of parts suppliers and vehicle producers face a number of challenges, suggesting that the state is unlikely to see near-term job growth in this sector.

Financial weakness remains in some households.

- Michigan's personal income growth of 3.2 percent in the first half of 2004 was slightly slower than in 2003 but roughly twice the pace of 2001 and 2002. Growth in wages and salaries, running about 3 percent, has been complemented by an upturn in dividends, interest, and rents, which account for about 14 percent of personal income in the state.

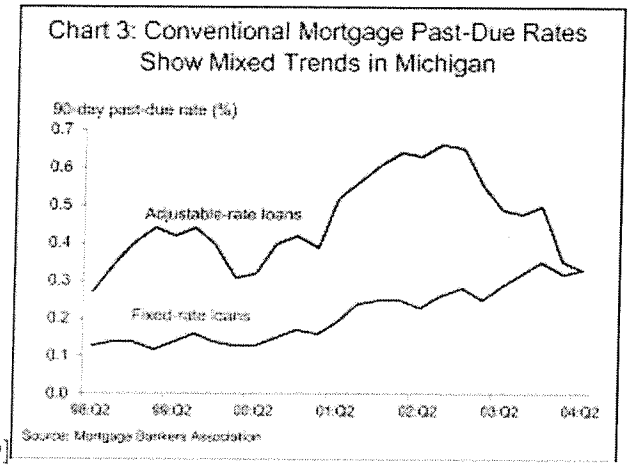
- Home price appreciation in Michigan remains moderate (See Chart 2). Consequently, the net worth of Michigan homeowners is benefiting less from home price appreciation than in some other states.



[D]

- Sluggish appreciation reflects that resale activity softened noticeably in recent quarters, and residential permits also are ebbing. These developments likely reflect Michigan's lackluster economic recovery and the aftermath of a flurry of sales and permits in 2003, in anticipation of rising mortgage rates.

- Residential mortgage past-due and foreclosure rates remain elevated relative to the historical experience of the state and the nation. The 90-day delinquency rate for fixed-rate conventional mortgages held by Michigan households continues to trend upward, whereas the past-due rate for adjustable-rate mortgages has returned to pre-recession levels (See Chart 3).



[D]

Community institutions' performance has strengthened.[1]

- Profitability rose in the third quarter compared with a year earlier (See Table 1). Banks and thrifts reduced taxes and overhead expenses, primarily salaries and benefits, and posted modest gains in net interest income and noninterest income.

Table 1: Lower Noninterest Expenses Help Community Institutions' Performance			
Income statement contribution (as a percentage of average assets)			
	3 months ended September 30		Percentage Point Change
	2003	2004	
Net Interest Income	3.73	3.76	0.03
Noninterest Income	1.34	1.39	0.05
Noninterest Expense	-3.33	-3.17	0.16
Provision Expense	-0.20	-0.18	0.02
Security Gains & Losses	0.04	0.02	-0.02
Income Taxes	-0.47	-0.54	-0.07
Net Income (ROA)	1.11	1.28	0.17

[D] Source: FDIC

- Strong loan growth and rising interest rates helped asset yields rise and contributed to improvement in the net interest margin.

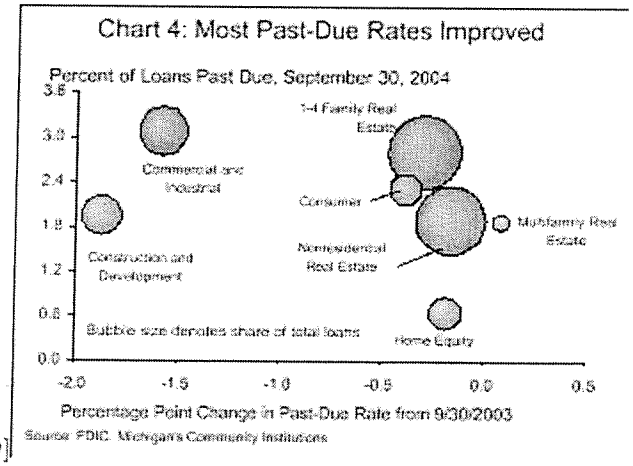
- Loan growth pushed the aggregate loan-to-asset ratio to 75 percent from 72 percent a year earlier. The most noteworthy growth was in the construction and development (C&D) segment, which grew more than 25 percent.

- Community institutions increasingly turned to large time deposits and brokered deposits to fund asset growth. Core funding declined during the past year, as did other borrowings such as Federal Home Loan Bank advances.

Community institutions' asset quality trends are favorable.

- Community banks and thrifts benefited from improved asset quality during the past 12 months, as delinquencies moderated and reserve coverage of nonperforming loans increased. To an unknown extent, rapid loan growth recently and the lack of seasoning of new loans also could be boosting broad measures of asset quality.

- The overall delinquency rate fell during the past year from 2.93 percent to 2.28 percent of total loans, and all major loan segments experienced improvement (See Chart 4).



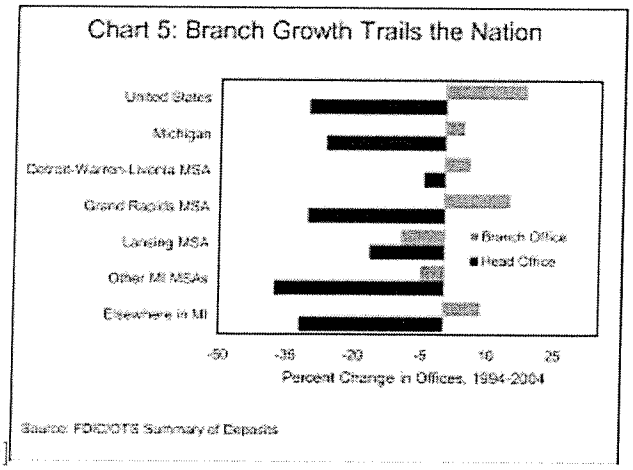
[D]

- Looking ahead, community banks will need to monitor their exposure to C&D loans. During the past year, C&D loans grew rapidly and now represents

more than 9 percent of total loans, the highest percentage in the Chicago Region. Future interest rate increases may pressure the feasibility of some commercial real estate projects.

Fewer headquarters and modest branching characterize the past decade.

- Michigan, like the nation, experienced significant bank consolidation from 1994 to 2004, with the number of head offices declining by 26 percent (See Chart 5).



[D]

- Unlike the rest of the U.S., Michigan has not experienced strong branch office growth. The Grand Rapids metropolitan area is an exception, with its stronger demographic trends likely prompting more branch growth.

- Reflecting these developments, bank and thrift deposits in Michigan rose 45 percent during the past decade, about 10 percentage points slower than the national median.

[1] Community institutions are insured banks and thrifts with less than $1 billion in assets, excluding new (less than three years old) and specialty banks and thrifts.

Michigan at a Glance

General Information	09-04	09-03	09-02	09-01	
Institutions (#)	174	179	180	182	
Total Assets (in thousands)	198,144,580	191,797,525	166,930,704	172,895,338	168,4
New Institutions (# < 3 years)	5	8	13	21	
New Institutions (# < 9 years)	38	38	39	38	

Capital	09-04	09-03	09-02	09-01
Tier 1 Leverage (median)	9.19	9.13	8.87	8.76

Asset Quality	09-04	09-03	09-02	09-01
Past-Due and Nonaccrual (median %)	1.87%	2.02%	2.10%	2.24%

Past-Due and Nonaccrual >= 5%	14	24	15	23
ALLL/Total Loans (median %)	1.24%	1.33%	1.29%	1.24%
ALLL/Noncurrent Loans (median multiple)	1.78	1.43	1.37	1.73
Net Loan Losses/Loans (aggregate)	0.31%	0.53%	0.62%	0.50%

Earnings (Year-to-Date Annualized)	**09-04**	**09-03**	**09-02**	**09-01**
Unprofitable Institutions (#)	8	11	14	20
Percent Unprofitable	4.60%	6.15%	7.78%	10.99%
Return on Assets (median %)	0.97	1.13	1.15	1.09
25th Percentile	0.70	0.77	0.75	0.73
Net Interest Margin (median %)	4.05%	4.13%	4.31%	4.33%
Yield on Earning Assets (median)	5.69%	6.09%	6.94%	8.14%
Cost of Funding Earning Assets (median)	1.69%	2.06%	2.63%	3.84%
Provisions to Avg. Assets (median)	0.14%	0.19%	0.20%	0.17%
Noninterest Income to Avg. Assets (median)	0.70%	0.94%	0.72%	0.69%
Overhead to Avg. Assets (median)	2.97%	3.07%	3.05%	3.11%

Liquidity/Sensitivity	**09-04**	**09-03**	**09-02**	**09-01**
Loans to Deposits (median %)	93.50%	90.34%	89.63%	90.35%
Loans to Assets (median %)	75.15%	73.44%	73.95%	74.08%
Brokered Deposits (# of Institutions)	68	64	64	56
Bro. Deps./Assets (median for above inst.)	7.97%	7.02%	7.26%	4.02%
Noncore Funding to Assets (median)	19.71%	17.89%	20.19%	20.93%
Core Funding to Assets (median)	68.02%	70.83%	68.69%	68.30%

Bank Class	**09-04**	**09-03**	**09-02**	**09-02**
State Nonmember	102	102	102	101
National	23	26	27	27
State Member	29	31	31	34
S&L	2	2	2	2
Savings Bank	13	13	13	14
Stock and Mutual SB	5	5	5	4

MSA Distribution	**# of Inst.**	**Assets**	**% Inst.**	**% Assets**
No MSA	74	11,575,305	42.53%	5.84%
Detroit MI PMSA	38	117,723,602	21.84%	59.41%
Grand Rapids-Muskegon-Holland MI	19	46,504,453	10.92%	23.47%
Ann Arbor MI PMSA	11	2,618,242	6.32%	1.32%
Lansing-East Lansing MI	10	7,612,876	5.75%	3.84%

Saginaw-Bay City-Midland MI	6	3,485,690	3.45%	1.76%
Kalamazoo-Battle Creek MI	6	539,396	3.45%	0.27%
Flint MI PMSA	4	6,198,797	2.30%	3.13%
Benton Harbor MI	4	1,760,585	2.30%	0.89%
Jackson MI	2	125,634	1.15%	0.06%

Last Updated 12/30/2004

Questions, Suggestions & Requests

FEDERAL DEPOSIT INSURANCE CORPORATION
INSURING AMERICA'S FUTURE

Deposits of all FDIC-Insured Institutions
State Totals by Charter Class

Operating in: **Michigan**

Data as of June 30, 2004

(Dollars Amounts In Millions)

State Charter Class as of June 30, 2004	Total			Headquartered in state			Headquartered Outside of State		
	Number of			Number of			Number of		
	Institu-tions	Offices	Deposits	Institu-tions	Offices	Deposits	Institu-tions	Offices	Deposits
Commercial Banks	173	2,747	124,801	155	1,859	83,357	18	888	41,444
National Charter	35	1,234	62,135	24	368	21,348	11	866	40,788
State Charter	138	1,513	62,665	131	1,491	62,010	7	22	656
Federal Reserve Member	34	857	41,039	29	837	40,392	5	20	647
Federal Reserve Nonmember	104	656	21,627	102	654	21,618	2	2	9
Savings Institutions	22	254	11,272	20	209	11,115	2	45	157
Federal Charter Savings Associations	17	199	9,637	15	154	9,480	2	45	157
State Charter Savings Institutions	5	55	1,635	5	55	1,635	0	0	0
FDIC-Supervised Savings Banks	5	55	1,635	5	55	1,635	0	0	0
OTS-Supervised Savings Associations	0	0	0	0	0	0	0	0	0
U.S. Branches of Foreign Banks	0	0	0	0	0	0	0	0	0
Total	195	3,001	136,073	175	2,068	94,472	20	933	41,600

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Capital	**09-04**	**09-03**	**09-02**	**09-01**	**09-00**
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$100 on deposit for 1 year = $1 profit for that year

- A single "bad" loan for $100 loses
  - All of that deposit (which we still have to give back)
  - The $1 profit that we could have made
  - All of the expenses of trying to collect that loan

So we have to make 105 new "good" loans of $100 to make up for that one "bad" loan.

- Number of Banks 195
- Number of Branches 3,001
- Number of employees 60,000
- Number of customers
- Number of transactions per day
- Deposits $136 Billion
- Loans $125 Billion

(compare to State of Michigan Budget - $41.2 Billion)

- Assets $198 Billion

A Very Large Bank

Standard Federal (LaSalle)

$45 Billion – 4,900 employees

A Very Small Bank

1st State Bank of Decatur

$12 Million – 13 employees

The Typical Bank

$150 Million, 50 employees – Median

State Constitutional Provisions

Art. 4, Sec. 43.

Bank and Trust Company Laws

Sec. 43. No general law providing for the incorporation of trust companies or corporations for banking purposes, or regulating the business thereof, shall be enacted, amended or repealed except by a vote of **two-thirds** of the members elected to and serving in each house.

Banking Activities

Generally – most businesses can do whatever they want to – unless it is prohibited

Banks – are prohibited from doing something – unless specifically allowed to do it

Federal Agencies

Federal Reserve Board
Jennifer Johnson
Regs.comments@federalreserve.com
20th & C Streets NW
Washington, D.C. 20551

Each depositor insured to $100,000
FDIC
FEDERAL DEPOSIT INSURANCE CORPORATION

Federal Deposit Insurance Corp.
Robert Feldman
comments@fdic.gov
550 17th Street NW
Washington, D.C. 20429

Office of Thrift Supervision
Director, Information Services
regs.comments@ots.treas.gov
1700 G Street NW
Washington, D.C. 20552

Comptroller of the Currency
Regs.comments@occ.treas.gov
250 E Street SW
Mail Stop 3-2
Washington, D.C. 20219

Federal Regulations

Making Loans

Reserves (safety)

Community Reinvestment

Insurance

Wire Transfers

Foreign Issues

Securities

Credit Reporting

Unfair Acts

Public Records

Lending Discrimination

Electronic Transfers – ATMs

Consumer Protection Generally

International Operations

Loans to Employees

Recordkeeping

Holding Companies

Holds on Checks

Confidentiality

Mortgage Disclosures

Loans to Other Banks

Interest Rates

Deposits and Checks

Consumer Leasing

Privacy

Stocks Brokers Dealers

Lending Disclosures

Savings Disclosures

Deposit Insurance

Federal Preemption

- Agencies may occupy the entire issue
  - Example – Interest rates on loans
    Community Reinvestment

- Agencies may defer entirely to the state
  - Example – Contract law
    Liens and Security Interests

- Agencies may elect to share regulation with the state
  - Example – Mortgage disclosures
    Employment matters

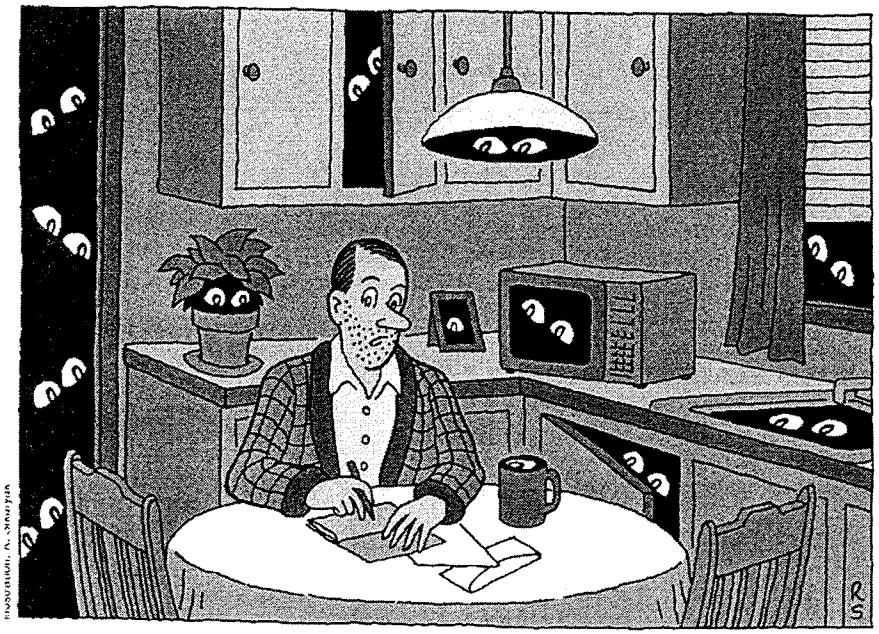
Some Issues

Privacy of Customer Information

It is implicit in the contract of the bank with its customers or depositors that **no information may be disclosed by the bank** or its employees concerning the customer's or depositor's account, and that **unless authorized by law or by the customer** or depositor the bank must be held liable for breach of the implied contract.

Some Issues

Privacy of Customer Information



"Am I paranoid or is my bank really watching me?"

Some Issues

Authorized (REQUIRED) by Law

Family Independence Agency and Attorney General – Child Support

US Treasury Department – Currency Transactions

– Suspicious Activity

US – Persons & Entities

Authorized (usually written consent) by Customer

Recent State ID Theft difficulties – March 1 Encryption

Or you need a court order or a subpoena

Mortgage Lending

Federal Law – 12 USC 2901 et seq.

Banks have an affirmative obligation to meet the credit needs in low and moderate-income neighborhoods.

Banks must lend to their entire market area.

Banks must have a strategy for lending in those neighborhoods.

Mortgage Lending

State Law – MCL 445.1601 et seq.

Prohibits a lender from

- denying a mortgage or home improvement loan or
- varying the terms of such a loan
- due to the racial or ethnic characteristics or trends in the neighborhood or
- the age of the structure or other structures in the neighborhood.

Mortgage Lending

20 Years (?) of Disclosures

- For about 20 years, starting in 1976, banks reported to the state banking regulator on every residential real estate loan made in Michigan.
- We reported the amount, the interest rate, the fees, the required down payment, the terms, the race of the applicant and other data on each loan.
- We reported this data by neighborhoods, zip codes and other criteria.
- No violations of law were found – none.
- The state stopped collecting this data – on 1,000s and 1,000s and 1000s of loans – because no violations were found – none.

ESSAYS ON ISSUES
THE FEDERAL RESERVE BANK OF CHICAGO
FEBRUARY 2005
NUMBER 211

Chicago Fed Letter

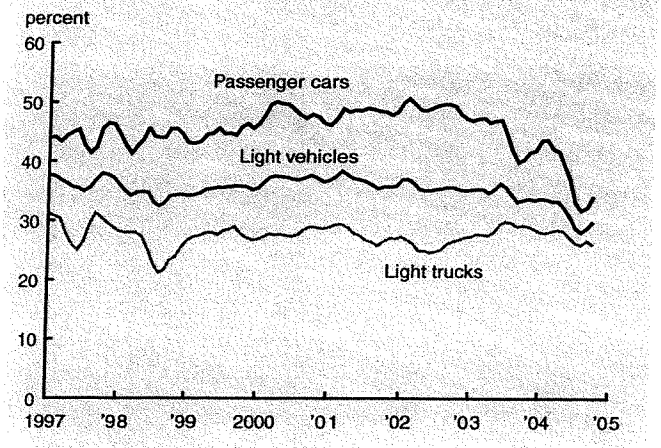
Caution ahead—Challenges to the Midwest's role in the auto industry

by Thomas Klier, senior economist

This article examines the recent break in the relationship between motor vehicle production and the auto region's employment, particularly the impact of the decline in Big Three market share.

U.S. light vehicle sales have continued at very solid levels over the past several years, averaging 16.7 million units since 2001.[1] Yet the unemployment rate in Michigan—the most auto intensive state in the U.S.—has stayed above the national and the Midwest average for over four years.[2] Like most durable goods, motor vehicle production exhibits stronger cyclical swings than the rest of economic activity. When things are going well, the auto region's employment conditions tend to be good. So how do we explain the recent break in the relationship between motor vehicle production and the auto region's employment?

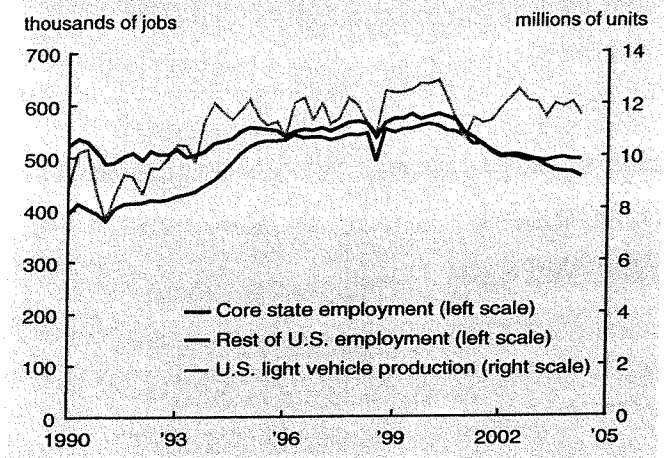
1. Seventh District production share



SOURCE: Ward's.

One possible explanation is an increase in U.S. vehicle sales produced outside the country. But the import share of light vehicle sales has increased only moderately, from 17% in 2000 to 20% at the end of 2004, and domestic production of light vehicles has averaged around 12 million units since 2001. A more plausible explanation for Michigan's elevated unemployment rate is a shift in the regional distribution of production. Although the number of light vehicles produced in the U.S. has held fairly steady during the last two years, auto production in the Seventh District, which includes the key auto sector states Michigan and Indiana, has performed quite differently (see figure 1). Indeed, the District's share of passenger car production has declined significantly vis à vis the rest of the country. That share fluctuated between 45% and 50% between 1997 and 2003, but has since fallen rapidly, reaching 31.7% in August 2004, its lowest level in over a decade. That development is also reflected in the District's share of auto industry employment (see figure 2). Until the end of 1996, the core of the auto region, the states of Michigan, Indiana, and Ohio, was home to the majority of auto industry jobs. And while the region's leadership gap over the rest of the country was shrinking during the first half of the 1990s, auto sector jobs grew in both the region and the nation during these years. From 1996 until the second half of 2002, auto industry employment was pretty evenly divided between the three core auto states and the rest of the country. Since then, however, auto industry employment in the core states has fallen off noticeably at a time of

2. U.S. light vehicle production and employment



SOURCE: Federal Reserve Board's Industrial Production Index and BLS.

rather stable levels of light vehicle production. At the same time, industry employment outside the three core auto states has remained stable.

What seems to be driving this development is a continued market share loss for domestic producers to foreign nameplates, an increasing share of which is being produced within the U.S. (see figure 3).[3] For example, Chrysler, GM, and Ford have lost over 6 percentage points of domestic sales to foreign producers since 2000, resulting in an all-time low market share for the Big Three of 58.7% in December 2004. In the context of the geography of the U.S. car industry that is an important trend, because the production facilities of foreign assemblers tend to be located outside the traditional auto-producing states of Michigan, Indiana, and Ohio.[4]

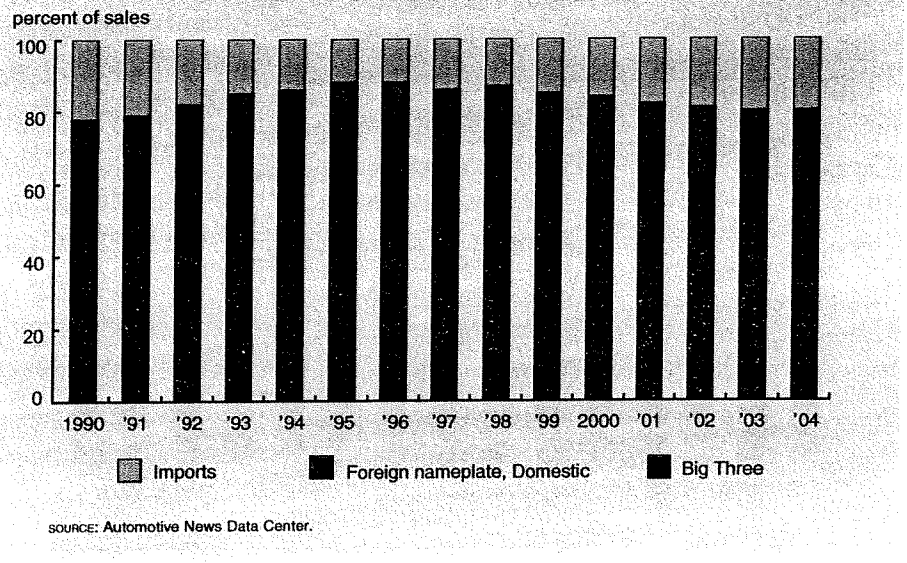
The economic importance of this geographic shift is magnified by the tight linkages between auto assembly and production of parts and components. On average, for every auto assembly job in the U.S. there are six in related parts production, as well as ancillary jobs in services and transportation.[5] More importantly, supplier plant locations tend to remain proximate to assembly plants because of just-in-time production requirements. Accordingly, the majority of an assembly plant's suppliers are typically located within one day's driving distance, which corresponds to about 450 miles.[6] All of this suggests that the erosion of Michigan's role in the auto industry—both assembly and related parts—is being driven by the ongoing loss of market share rather than by cyclical factors.

How has this recent adjustment played out in terms of employment? Figure 4 shows that the industry shed over 155,000 jobs between 2000 and 2003.[7] The vast majority of these are concentrated in the auto supplier segment of the industry rather than in assembly operations. Michigan, Indiana, and Ohio as a group fared worse than the rest of the country, losing 16.7% of their parts industry jobs compared with 10.7% for the remaining states. Among these three states, Michigan has fared the worst during the past three years, losing over 20% of its auto supplier employment. This performance gap is magnified by Michigan's strong reliance on the auto industry. The state is home to one-quarter of auto supplier employment, with the three core states jointly accounting for half.

Plant-level data allows us to trace the job losses for auto assembly plants and their "captive" suppliers (facilities owned and operated by the assembly companies, such as stamping or engine plants). Figure 5 shows that assembly plant employment fell by just over 2% overall between 2000 and 2003. That loss of jobs can be entirely accounted for by employment losses at domestic assembly facilities. The assembly plants of foreign companies added employment, most of it, however, outside the core auto region. A much bigger employment adjustment took place among the so-called captive parts plants, which are almost exclusively domestic captives of the Big Three. According to figure 5, these plants shed 35,000 jobs between 2000 and 2003, more than one-quarter of their employment. Once I adjust for plants that were sold to independent supplier companies and therefore dropped out of the captive category (but probably continued to operate), the tally of job losses falls to 19%.[8]

There are two main factors behind that rather dramatic number: Plant closures (including plants for which closings have been announced but not yet implemented) account for 28% of these job losses. The remaining 72% is attributable to job reductions at existing and continuing plants, representing productivity improvements as well as

3. U.S. light vehicle sales: 1990–2004



SOURCE: Automotive News Data Center.

4. Motor vehicle manufacturing employment decline

		2000	2003	% change
Assembly	U.S.	291.4	267.5	–8.2
	MI, IN, OH	143.3	124.3	–13.3
	Michigan	94.3	80.0	–15.2
	Other states	148.1	143.2	–3.3
Parts	U.S.	839.4	707.5	–15.7
	MI, IN, OH	432.6	355.5	–17.8
	Michigan	226.2	180.1	–20.4
	Other states	406.8	352.0	–13.5
Combined	U.S.	1,130.8	975.0	–13.8
	MI, IN, OH	575.9	479.8	–16.7
	Michigan	320.5	260.1	–18.8
	Other states	554.9	495.2	–10.7

NOTE: Assembly jobs are measured at NAICS 33611; that is, they include medium and heavy duty trucks. Employment is measured in thousands.
SOURCE: BLS.

5. Plant-level detail

		2000	2003	% change
Assembly plants	U.S.	160.16	156.8	–2.10
	MI, IN, OH	71.59	67.94	–5.11
	Michigan	42.31	38.02	–10.13
	Other states	88.57	88.87	0.34
Captive suppliers	U.S.	137.07	102.14	–25.49
	MI, IN, OH	112.91	85.97	–23.86
	Michigan	58.22	44.87	–22.93
	Other states	24.17	16.17	–33.10
Combined	U.S.	297.23	258.94	–12.88
	MI, IN, OH	184.5	153.91	–16.58
	Michigan	100.53	82.89	–17.55
	Other states	112.74	105.04	–6.83

NOTE: Jobs are measured in thousands.
SOURCE: Harbour Consulting, *Harbour Report*, 2004, 2001 and company websites.

the effects of greater outsourcing of parts production to non-captive suppliers, many of which are operating production facilities outside the United States. At the same time, a small number of U.S.-based foreign captives grew, but off of a very small base.

Unfortunately, there are no reliable time-series data available on plant-level employment in the independent auto supplier sector that would allow one to perform a similar analysis for that piece of the industry. But the aggregate numbers for independent suppliers presented in figure 4 show a relatively smaller loss of jobs in the non-traditional auto states as well. So the changing fortunes of domestic and foreign assembly plant customers appear to be profoundly reshaping the regional distribution of supplier employment.

At the same time, the globalization of parts production has been slowing output growth from the U.S. overall. U.S. auto parts production grew by 12.8% between 1997 and 2002, but during the same time imports of auto parts grew by 52.1%.[9] In 2003, the largest source countries for auto parts remained Canada and Mexico. Together these two countries accounted for 55.7% of all parts imports. Imported parts from Asia represented 29%. Within that group, Japan's share has dropped by 6% to 18.2% in the past ten years. Imports from China have more than tripled, but off of a very small base. China now accounts for 4.1% of all auto parts imports.

Conclusion

Since the geography of production of light vehicles is different for domestic and foreign producers and suppliers, the continued decline of Big Three market share is having a noticeable impact on the core auto region, especially Michigan. Between 1995 and December 2004, the domestic share of the U.S. light vehicle market dropped from 73.2% to 58.7%. Assuming a minimum efficient scale of about 200,000 units for a modern assembly plant, that corresponds to the capacity of about ten assembly plants.[10] In fact, four Big Three assembly plants have been closed in the U.S. and Canada since then and another four are set to close within a year.

The data presented here clearly show that the larger impact of a retrenchment of domestic producers plays out in the supplier sector. Michigan stands out as the heart of the supplier industry. While it is performing only slightly worse than Indiana and Ohio in terms of the share

Chicago Fed Letter is published monthly by the Research Department of the Federal Reserve Bank of Chicago. The views expressed are the authors' and are not necessarily those of the Federal Reserve Bank of Chicago or the Federal Reserve System.

ISSN 0895-0164

of auto industry jobs lost, the auto sector plays a much more important role in Michigan's economy than it does in any other state.[11]

Still, while the old-line auto states have been losing production to the southern end of the auto corridor, Michigan has strengthened its role as the center of headquarters, research, and design (R&D) functions in this industry during the past 15 years. About half of the largest 150 auto supplier companies are headquartered in the Detroit area, and virtually every global automotive company retains a significant R&D presence there. Furthermore, the fortunes of individual companies are historically volatile. The Big Three and their suppliers may yet mount a concerted comeback in the marketplace.

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[1] The term light vehicles refers to passenger cars and light trucks, which include minivans and sport utility vehicles.

[2] Midwest here refers to the Seventh District states of Wisconsin, Iowa, Illinois, Michigan, and Indiana; Ohio is not included.

[3] While foreign producers entered the market for cars first, they have since added a growing number of light truck models, both imported and produced in North America.

[4] See Thomas Klier, Paul Ma, and Daniel McMillen, 2004, "Comparing location decisions of domestic and foreign auto suppliers," Federal Reserve Bank of Chicago, working paper, No. 27, and Thomas Klier, 2004, "Challenges to the U.S. auto industry," *Chicago Fed Letter*, Federal Reserve Bank of Chicago, March, No. 200a. Michigan, Indiana, and Ohio are home to 44% of all light vehicle assembly plants in the U.S. Of these, 80% are Big Three facilities. However, six of the 13 U.S. foreign-owned light vehicle assembly plants are located south of Indiana and Ohio.

[5] To arrive at that factor I relate the number of light vehicle assembly jobs from figure 5 to the sum of parts jobs from figure 4 and captive supplier jobs from figure 5. We adjust the parts jobs from figure 4 to allow for an undercount (see endnote 7). For a detailed analysis of ancillary jobs related to the auto sector see Sean McAlinden, Kim Hill, and Bernard Swiecki, 2003, *Economic Contribution of the Automotive Industry to the U.S.—An Update*, Ann Arbor, MI: Center for Automotive Research.

[6] See Thomas Klier, 2000, "Spatial concentration in the U.S. auto supplier industry," *The Review of Regional Studies*, Vol. 29, No. 3.

[7] In fact, that number probably undercounts the level of job losses, because the size of the auto supplier industry is notoriously hard to gauge with aggregate data. Ongoing research with data on auto parts imports suggests that the undercount in the auto parts sector is on the order of 15%.

[8] That is a lower bound, because it is not known to what extent the new owners of the former captive supplier plants reduced employment.

[9] Motor vehicle parts imports grew from 18.4% of U.S. production in 1997 to 34.1% in 2002.

[10] See Joseph F. Francois and Dean Spinanger, 2004, "Regulated efficiency, world trade accession, and the motor vehicle sector in China," Tinbergen Institute, discussion paper, No. 2004-049/2. The authors note that for assembly plants producing a single model, the efficient scale is just over 200,000 cars per year. The size of the market for light vehicles in the U.S. was around 15 million units during the second half of the 1990s and has averaged 16.5 million units since then. Applying these numbers to calibrate the impact of a 14 percentage point market share loss corresponds to the capacity of ten to 11 assembly plants (at 200,000 units per plant).

[11] This issue is receiving great attention in Michigan. See, for example, Governor Granholm's speech given at the Traverse City Management Briefing Seminar last August at http://www.michigan.gov/gov/0,1607,7-168-23442_21974-98324—M_2004_8,00.html and Terry Kosdrosky, 2004, "Economic downshift," in *Crain's Detroit Business*, November 19, p. 1.

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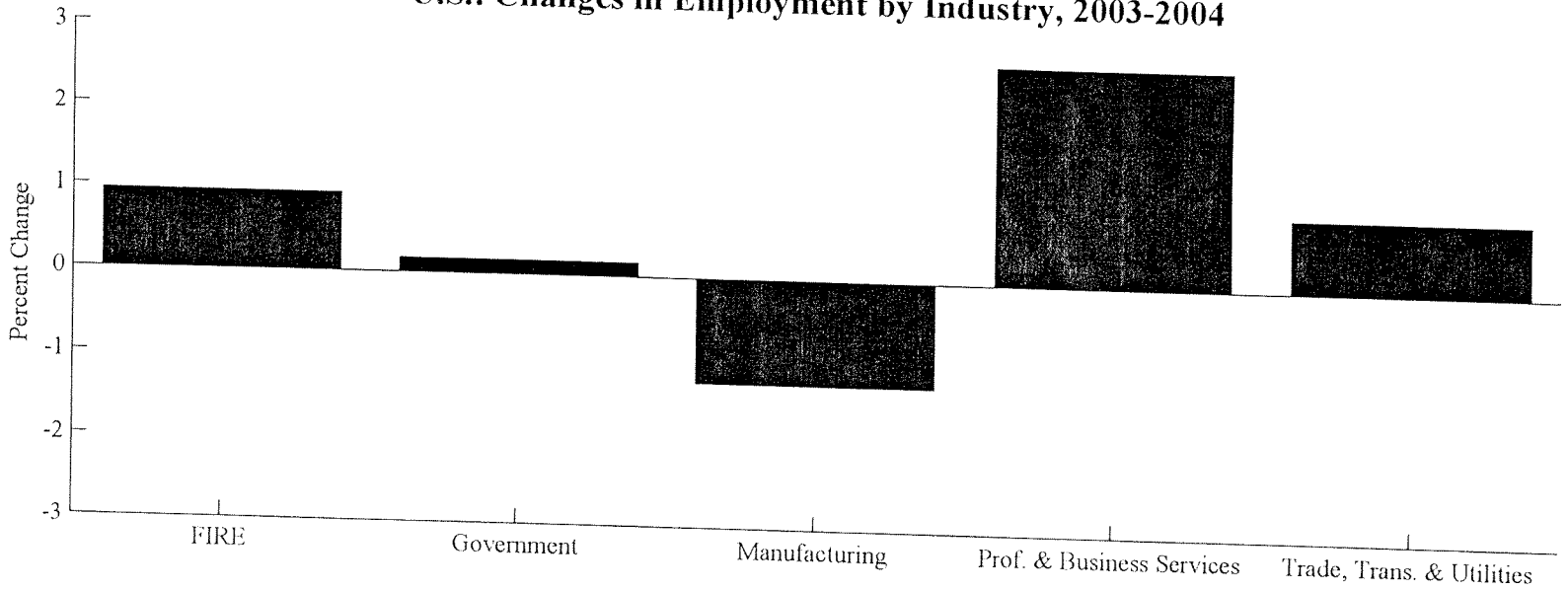
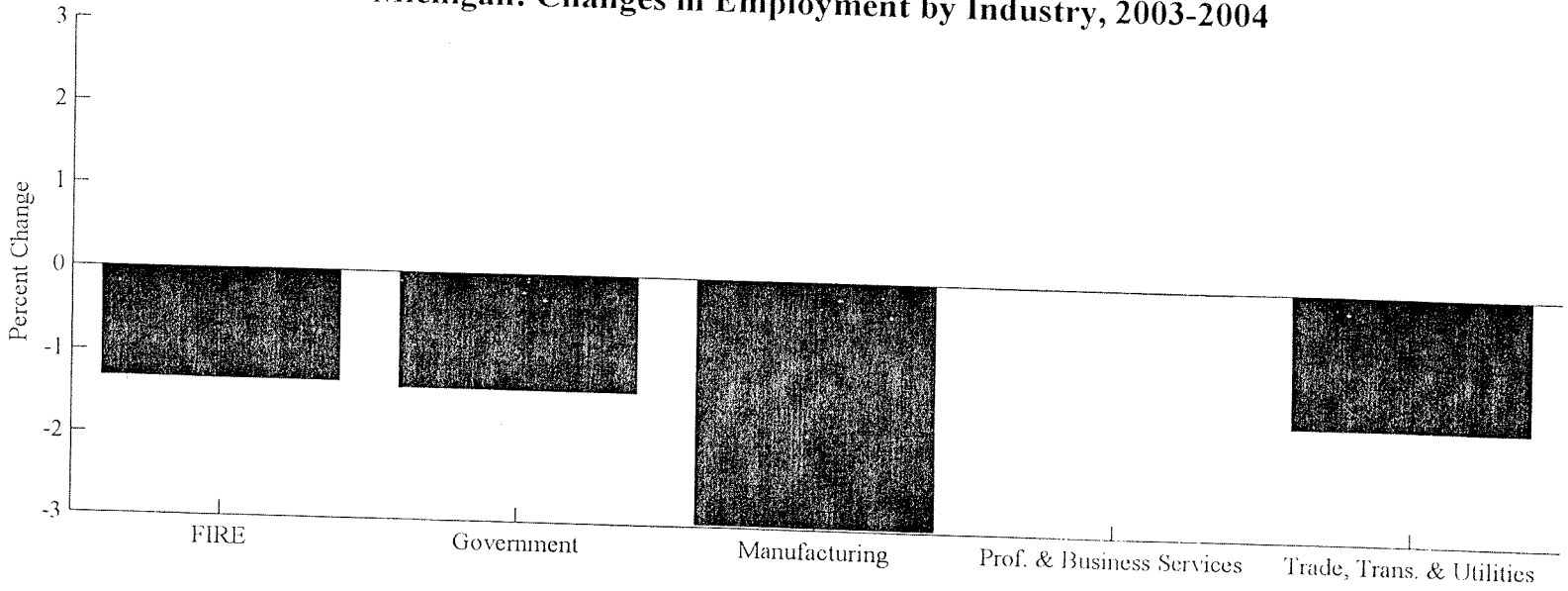
U.S.: Changes in Employment by Industry, 2003-2004



Michigan: Changes in Employment by Industry, 2003-2004



Analysis: Anderson Economic Group
Data Source: Bureau of Labor Statistics
Generated Date: 02/07/2005

3.5 Percent Growth Forecast

FEBRUARY 2005

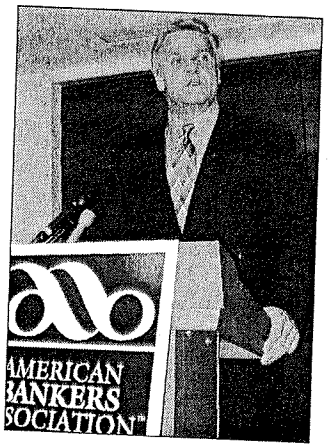
By Patrick Dalton

The economy will grow at an annual rate of 3.5 percent in 2005 and will approach full employment by the end of the year, ABA's Economic Advisory Committee said last week.

"The U.S. economy is moving toward its full potential, with business investment increasing and improved wage gains. Consumer spending will play a supporting role buoyed by new jobs and rising income," said EAC Chairman Richard DeKaser, SVP and chief economist at National City Corp. in Cleveland.

The EAC predicted that the unemployment rate will drop to almost 5 percent by year-end 2005. The committee also believes the Federal Reserve will raise interest rates 25 basis points at its meeting this week, and another 25 basis points at its March meeting.

"With monetary policy still highly accommodative and the economy approaching full employment, the Fed will continue its campaign of returning interest rates to historic norms. The Fed is taking its foot off the accelerator, without hitting the brakes," DeKaser said.



DeKaser

Photo by Patrick Dalton

Consumer credit will continue to grow at a moderate pace, the EAC said. After three years of decline, commercial and industrial loans are expected to grow along with stronger business capital and more inventory investment.

SAVING MICHIGAN'S CAPITAL ACCESS PROGRAM

Proposition: The Michigan Bankers Association urges the Michigan Economic Development Corporation to reconsider its decision to end the Capital Access Program effective February 28, 2001.

CAP is Michigan's premier program assisting small businesses and represents an outstanding example of a public-private partnership.

"The Michigan Strategic Fund's (MSF) Capital Access Program, launched in August 1986, provides banks with a flexible and nonbureaucratic tool to make business loans, which are somewhat riskier than a conventional bank loan, in a manner consistent with safety and soundness regulation. The Capital Access Program can thus assist banks in expanding their markets and better serving their customer base, and can have an important positive impact on the creation of jobs and improving the effectiveness of Michigan's economy by supporting the growth and success of Michigan businesses." (Opening Paragraph from the June 1991 Annual Report - Capital Access Program)

By December 31, 2000, the program had assisted 79 banks in putting on nearly $505 million in enrolled loans to small businesses.

Leverage and Cumulative Data

A key feature of the program from the state's viewpoint, is the high degree of leverage of public resources from a relatively small amount of state funds. In 1991, the leverage ratio was 20 to 1. As of year-end 2000, the leverage has increased to 26.17 to 1.

Smallest Loan Made:	$400.00
Largest Loan Made:	$2,420,250.00
Average Loan size:	$55,351.05

Over 80% of the loans have been under $100,000
Over 61% of the loans have been made to borrowers with sales under $300,000, 29% to borrowers with sales $1 million and over
33% of the loans went to the service sector, 27% to retail, and 14% to manufacturing

Long-Term Program Contemplated

The resolution establishing the program also included a strong statement of intent of the Board's long-term intentions regarding the program.

How CAP Works

CAP is based on an insuring concept, but is fundamentally different from other guarantee programs, such as the SBA 7(a) program. That program guarantees a percentage of a loan on a loan-by-loan basis, while Capital Access is based on a total portfolio concept.

A special reserve fund is set up in each participating bank to cover future losses from a portfolio of loans that the bank makes under the program. The special reserve is owned and controlled by the state, but it is earmarked in that bank's name. A bank can withdraw funds from its earmarked reserve only to cover losses on loans enrolled in the program.

The reserve fund is created from three sources: from the borrower making a premium payment (negotiated with the lender from a minimum of 1.5% up to 3.5% of the loan), from the bank matching the borrower's payment, and finally from the state matching the combined total of the borrower's and the bank's payments.

The average state funding liability has been approximately $2 million per year.

Half of the interest earned on the funds in the bank's earmarked reserve will stay in the reserve, to help build it up. The state is authorized to withdraw the other half of the interest.

Why CAP Works

The free market is allowed to work in this program, and intelligent private sector decision-making is facilitated.

A. Benefits to the Small Business Borrower

The primary users are small businesses that would not otherwise be able to obtain conventional bank financing. Access to bank financing, versus alternate non-bank sources, is therefore a key feature.

This program is a bit more expensive to the borrower than a conventional bank loan because of the reserve payment. However, the borrower's reserve fund costs can be financed at the borrower's option.

Very few loan type restrictions are in place, thus enabling a broad range of small businesses to participate in the program.

B. Benefits to Main Street and Michigan's Core Communities

While the primary focus of the MEDC is shifting to high-tech firms and larger business enterprises, most inner cities and rural communities across Michigan still rely on small business success to help keep their communities alive and healthy, keep their store fronts filled, keep their youth employed, and ultimately keep main street from slowly dying. Many large businesses began in a garage and it's programs like CAP that enabled that to happen.

According to MEDC data, CAP loans have benefited businesses located in virtually every county in this state. The success stories are many, some of which are detailed at the end of this paper.

C. Benefits to the State

Michigan program - model for other states. This public-private partnership was the first of its kind in the country and has been copied by 20 other states since 1986. It is the state's premier program assisting small business.

Minimal Involvement. Aside from marketing efforts in the early years, the program now virtually runs itself. The state devotes at the most one FTE to the program, a technician, whose primary duties revolve around receiving and reviewing the one-page enrollment form, entering the data from the form into a database, and issuing the check for the state's contribution to the reserve fund. A program manager reviews the form. In terms of volume, 58 loans were enrolled in 2000.

Minimal Risk. Risk is limited to the state's contribution to the reserve fund, which is to be reimbursed with any loan loss recovery by the bank. With minimal program restrictions, it's the bank, not the state, that negotiates the terms of the loan. The bank has incentive to be prudent so that that reserve fund continues to grow and be available for future losses.

The state has the right to subrogate to the rights of the bank for all loans.

Representations and warranties are made by the bank to the state to protect it from non-compliance with program requirements.

Eligibility is broad-based as possible to help maximize the impact on Michigan's economy and to avoid second-guessing private market decisions.

The state retains the absolute discretion to terminate a bank from the right to make new loans under the program.

The state owns the funds held in the reserve account and is entitled to withdraw half the interest earned in each reserve account.

D. Benefits to the Lender

More efficient than SBA program. A central feature of the program is the flexibility of the program and its extremely nonbureaucratic administration. Its ease of use and turn-around time for enrollment and for claim filing is superior to the federal SBA 7(a) loan guarantee program.

CAP allows for more aggressive lending. The earmarked reserve enables a bank to be more aggressive in making loans and expanding its market. However, if a bank's loss rate were to exceed the coverage provided by its reserve, the bank would be at risk for that excess loss. Thus, there is a clear built-in incentive for a bank to be prudent.

The reserve enables a bank to withstand a substantially higher loss rate than it could tolerate under a conventional loan portfolio; thus the program enables a bank to prudently make "almost bankable loans." In addition, as the reserve begins to build up, and as the bank gains more experience under the program, the bank may gradually evolve to a more aggressive posture.

Maximum Flexibility. It is completely up to the bank to determine how it wants to use the program in a manner that best suits the needs of the bank and its customers.

When filing a loan for enrollment under the program, the bank has the option of covering an amount that is less than the full amount of the loan.

It allows the bank to work with a borrower after the bank has made a loan. The bank can subsequently recast it as often as may be desirable without having to obtain approval from the state.

The program allows for coverage of additional funds under a refinancing.

The program can be used for lines of credit.

Few restrictions on the type of loan enables the bank to build up a portfolio to take maximum advantage of the portfolio insurance effect, thereby making the program more attractive and effective.

Claims are filed on a half-page form and are paid at the time the loan is recognized as a loss prior to exercising the bank's collateral rights or other legal remedies, and may include principal charged off, plus accrued interest, plus out-of-pocket expenses.

Examples of CAP Success Stories

Comment from a Banker: Our bank has been able to serve small business well thanks to the CAP program. In fact, it helped to stimulate our own bank's growth! We went from 6 employees in 1990, to 58 at present. Our bank has $5.3 million enrolled in CAP. I can say that the SBA programs are far too cumbersome and expensive to service in many cases, and that without CAP, a lot of loans would not have been made that otherwise have been. Eliminating CAP equates to fewer small businesses, fewer jobs created, fewer services bought and produced, and less space leased. It's a very good program. *Rick James - V.P. Loan Administration, Ann Arbor Commerce Bank.*

1. Upper Peninsula - Marquette - Wells Fargo Bank

A small manufacturing company was a startup in 1995. It manufactured polyurethane products such as padding to go under basketball floors, cement mixer liners and other industrial products. They rented space from the city of Marquette in a facility that was sitting empty. Our initial loan was $500 thousand with a CAP participation.

Today the company employs 90 people, has expanded and is shipping product to the Netherlands and France. Marquette had zero manufacturing jobs until this company came along. The city is happy their idle facility is now fully occupied. We are happy and so is the company. "This is a great story for this town."

2. Lower Michigan - Chelsea - Chelsea State Bank

In January 1995, a recently graduated Veterinarian approached our bank for a loan to start her new practice in Chelsea. With no collateral, track record nor business background, an easy turndown was in order. However, she presented a solid business plan, and the enthusiasm to warrant a $25 thousand start up loan funded through CAP. Today she is a valuable asset to our community.

3. Southeast Michigan - Detroit - Comerica Bank

ABC is a power tools supplier primarily for the automotive industry. The company was started in 1987. The Comerica Bank relationship started in 1990 with a $100 thousand secured line of credit and a $20 thousand secured term loan. The facilities were secured by equipment, accounts receivable, inventory, certificate of deposit, 2nd mortgage and the owner's home and backed by the CAP program for $70 thousand.

The company has successfully matured from approximately $900 thousand in sales in 1991 to over $12 million in sales for 2000. The lending relationship today is over $3.4 million. Comerica was initially able to finance it in 1990 due to the additional support offered through the CAP program.

4. Central Michigan - Lansing - Capitol National Bank

A. In 1991, we loaned $200 thousand to a start up car-haul trucking company. Their revenue today is $25 million with 181 employees.

B. In 1995, we extended a $50 thousand line of credit to an electronic processing equipment manufacturer. It now has sales of $8 million for the first six months of the current fiscal year; has enjoyed a recent successful IPO, employs 80 workers and, has enjoyed a 110% 5 year average sales growth.

5. West Michigan - Muskegon - Muskegon Commerce Bank

This loan ($800 thousand) was made to a body shop owner located in an economically challenged area of the city. The loan enabled the owner to double the size of his business and in turn hire an additional 3 people with the expansion.